IN THE

Supreme Court of the United States

OCTOBER TERM — 1944

NUMBER 23

E. JACK SMITH, JACK CLARK, R. L. RIVERS and W. GORRY SMITH, partners trading under the firm name of E. JACK SMITH, CONTRACTOR,

Petitioners-in-Certiorari

vs.

COMER DAVIS, REESE PERRY and JOHN C. TOWNLEY, as Board of County Tax Assessors of Fulton County, and GUY MOORE, as Tax Receiver, and T. E. SUTTLES, as Tax Collector of Fulton County, Georgia,

Respondents-in-Certiorari

SPECIAL BRIEF OF RESPONDENTS-IN-CERTIORARI RELATING TO TITLE 31, SECTION 742 OF THE UNITED STATES CODE

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Title 31, Section 742 of the United States Code, with respect to which this brief was requested, reads as follows:

"Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the

United States, shall be exempt from taxation by or under State or municipal or local authority. (R.S., Sec. 3701)"

This brief and argument will be divided into the following sections:

I. Our contention that portions of those Acts of Congress from which this section of the Code is codified relate exclusively to interest-bearing securities of the United States.

II. Prior judicial interpretation of this section of the United States Code forbids its application to Georgia's attempt to levy a uniform property tax against Georgia's own citizens.

III. Any attempt by Congress to prohibit the State from levying a uniform property tax upon the State's own citizens would be an unwarranted extension of the instrumentalities rule as defined in *McCulloch* vs. *Maryland*, 17 U. S. (4 Wheat.) page 316, and accordingly unconstitutional.

IV. A recapitulation of new authorities which were cited by counsel for Respondents-in-Certiorari only on oral argument.

V. Restatement of *Second* heading on page 29 of Original Brief.

I.

Our Contention that Portions of those Acts of Congress from which this Section of the Code is Codified Relate Exclusively to Interest-Bearing Securities of the United States.

The seven (7) Acts from which this section of the United States Code is codified are listed in a historical note to Title 31, United States Code Annotated, page 356.

The substance of these acts and the portion thereof from which the Code section is derived are as follows:

(a) Act approved December 25, 1862 (12 Stat., pp. 345 and 346, Chapter 33, Section 2 of an act entitled:

> "An Act to Authorize the Issue of United States Notes and for the Redemption or Funding thereof and for Funding the Floating Debt of the United States."

Section 2 of this Act relates to provisions for funding the Treasury notes and floating debt of the United States. For that purpose, the Secretary of the Treasury was authorized "to issue on the credit of the United States coupon bonds or registered bonds—bearing interest at the rate of six per cent per annum payable semi-annually."

Only the last clause of Section 2 relates to tax exemption as follows:

> "and all stocks, bonds and other securities of the United States held by individuals, corporations or associations within the United States, shall be exempt from taxation by or under State authority."

(b) Act approved March 3, 1863 (12 Stat., pp. 709 and 710), Chapter 73, Section 1 of an act entitled:

"An Act to Provide Ways and Means for the Support of the Government."

This act authorizes the Secretary of the Treasury to borrow on the credit of the United States a sum not exceeding three hundred million dollars for the current fiscal year and six hundred million dollars for the next fiscal year and — to issue therefor coupon or registered bonds — bearing interest at a rate not exceeding six per cent per annum.

The first clause of the last sentence of Section 1 of this statute (12 Stat., p. 710) relates to tax exemption and reads as follows:

"and all bonds and Treasury notes or United States notes issued under the provisions of this Act shall be exempt from taxation by or under State or municipal authority," etc.

(c) Act approved March 3, 1864 (13 Stat. p. 13), Chapter 16, Section 8 of an act entitled:

"An Act Supplementary to an Act entitled, 'An Act to Provide Ways and Means for the Support of the Government' Approved March Third, Eighteen Hundred and Sixty-three."

This act provides:

"That in lieu of so much of the loan authorized by the Act of March Third, Eighteen Hundred Sixty-three, to which this act is supplementary, the secretary of the Treasury is authorized to borrow—on the

credit of the United States not exceeding two hundred million dollars during the current fiscal year and to prepare and issue therefor coupon or registered bonds of the United States—bearing interest not exceeding six per cent per annum payable on bonds not over one hundred million dollars annually and on all other bonds semi-annually."

The last clause of the first sentence in this section 1 (13 Stat., p. 13) relates to tax exemption and reads as follows:

"and all bonds issued under this act shall be exempt from taxation by or under State or municipal authority."

(d) Act approved June 30, 1864, (13 Stat., p. 218), Chapter 172, Sections 1 and 2 of an act entitled

"An Act to Provide Ways and Means for the Support of the Government, and for other Purposes."

This act authorized the Secretary of the Treasury to borrow on the credit of the United States four hundred million dollars and to issue therefor coupon or registered bonds of the United States—bearing interest annually not exceeding six per cent payable semi-annually.

The third sentence of Section 1 of this chapter reads as follows:

"And the Secretary of the Treasury may dispose of such bonds, or any part thereof, and of any bonds commonly known as Five Twenties remaining unsold in the United States, or if he shall find it expedient in Europe, at any time, on such terms as he may deem most advisable, for lawful money of the

United States, or at his discretion, for Treasury notes, certificates of indebtedness, or certificates of deposit issued under any act of Congress."

The last sentence of this section relates to tax exemption and reads:

"and all bonds, Treasury notes and other obligations of the United States shall be exempt from taxation by or under any State or municipal authority." (13 Stat., p. 218).

A portion of Section 2 of this act was referred to in the Act of January 28, 1865 quoted below. It authorized the Secretary of the Treasury to issue "on the credit of the United States, and in lieu of an equal amount of bonds authorized by the preceding section, and as a part of said loan, not exceeding two hundred million dollars in Treasury notes—bearing interest not exceeding the rate of seven and three tenths per cent payable to lawful money at maturity, or, at the discretion of the Secretary, semi-annually." (13 Stat., p. 218.)

(e) Act approved January 28, 1865 (13 Stat., p. 245), Chapter 22, Section 1 of an act entitled:

"An Act to Amend an Act Entitled, 'An Act to Provide Ways and Means for the Support of the Government and for Other Purposes' Approved, June Thirtieth, Eighteen Hundred Sixty-four."

This act reads in part as follows:

"That in lieu of any bonds authorized to be issued by the first section of the act entitled, 'An Act to Provide Ways and Means for the Support of the Government' approved June Thirtieth, Eighteen Hundred

Sixty-four, that may remain unsold at the date of this act, the Secretary of the Treasury may issue, under the authority of said act, Treasury notes of the description and character authorized by the second section of said act," etc.

The last clause of this Section 1 (13 Stat., p. 245) relates to tax exemption and reads as follows:

"and such notes shall be exempt from taxation by or under any State or municipal authority."

(f) Act approved March 3, 1865 (13 Stat., p. 469), Chapter 77, Section 2 of an act entitled:

"An Act to Provide Ways and Means for the Support of the Government."

This act conferred upon the Secretary of the Treasury the authority to borrow, on the credit of the United States, in addition to amounts heretofore authorized, any sums not exceeding in the aggregate six hundred million dollars and to issue bonds or Treasury notes therefor."

Section 2 of this act relates to the manner of disposition of the bonds and authorizes under certain conditions, their issuance in payment for any requisition for materials and supplies.

The last clause of this Section 2 (13 Stat., p. 469) relates to tax exemption and reads as follows:

"and all bonds or other obligations issued under this act shall be exempt from taxation by or under State or municipal authority."

(g) Act approved July 14, 1870 (16 Stat., p. 272), Chapter 256, Section 1 of an act entitled:

CASES CITED

CASES CITED (Continued)

CASES CITED (Continued)

PARAGRAPHS OF GEORGIA CONSTITUTION AND GEORGIA CODE SECTIONS CITED

GEORGIA LAWS CITED

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BRIEF OF RESPONDENTS-IN-CERTIORARI

PART I.

REPLY TO PETITIONERS' STATEMENT OF THE CASE

Petitioners have not clearly stated the issue, when in their brief (pages 3 and 4) they define the issue to be one of "Constitutional immunity from local taxation of open accounts when owed by the Federal Government."

We deem the issue to be an issue as to whether open accounts privately owned and otherwise subject to ad valorem tax under the Constitution and laws of Georgia enjoy a constitutional immunity because of the fact that the debtor (i.e., the person who owes the account—not the taxpayer) happens to be the Federal Government.

In our opinion, the following additional statement of facts, not clearly presented in petitioners' statement, will serve the convenience of the Court:

The equitable bill (R. 5 to 10) challenged the authority of tax officials of Fulton County to assess against the partnership ad valorem taxes for State and County purposes for the year 1942 on accounts receivable and certain certificates of indebtedness issued by the State of Georgia Highway Department.

Equitable suits in Georgia are commenced by petition to the Superior Court.

The property sought to be taxed belonged to the contractors and was owned by them on January 1, 1942, which is the effective tax date in Georgia (equitable bill, paragraph 5, R. 5).

The equitable bill alleged (paragraphs 5 and 6, R. 5 and 6) that the property sought to be taxed falls into four (4) groups as follows:

1. An account receivable owing to contractors by Camden County, Georgia, in the amount of $1,102.14.

2. An account receivable owing to contractors by the State of Georgia in the amount of $15,086.84.

3. An account receivable owing to contractors by the United States Government in the amount of $29,831.10.

4. Various certificates of indebtedness issued to contractors by the Highway Department of the State of Georgia in the amount of $117,050.68.

Petitioners' statement of "Questions Presented" in their petition for certiorari and also their statement of "Questions Presented" on page 4 of their brief each disclose that relief is sought here only with respect to the open account "due and owing by the United States of America."

Petitioners-in-Certiorari seem to recognize, as indeed they must, that the decision of the Supreme Court of Georgia is not subject to review insofar as it applies the Georgia Constitution and laws to the accounts receivable owing by the State and by Camden County, and insofar as it applies the Georgia Constitution and laws to certificates of indebtedness owing by the State Highway Department. Accordingly, the sole question presented related to the taxability of another account receivable owned on the same date by the same contractor and owing to the contractor by the United States Government.

Other Material Facts Appearing in the Record

The following material facts also appear from the record:

1. The account in question was due "for furnishing paving materials, grading, draining and laying paving materials in the construction of United States Army Air-

ports at Savannah, Georgia. (Equitable bill, paragraph 9, R. 6).

2. Paragraph 9 of the equitable bill was amended (R. 15, 16) to allege that "the work, labor and materials furnished by Petitioners (i.e., contractors) to the United States Government were furnished for the purpose and in connection with the construction of two airports or bases located at Savannah, Georgia, for the use of the United States Army." By this amendment to Paragraph 9, Exhibit B (R. 20 to 32) and Exhibit C (R. 32 to 44) were incorporated in the record and identified as the written contracts pursuant to which the contractors furnished their "work, labor and material."

3. This amendment to paragraph 9 states that the sum of $29,831.10 due Petitioners (i.e., contractors) on January 1, 1942, represented "the balance due under the terms of said contracts," and further that "the balance aforesaid was in the nature of an open account and represented an account receivable in the hands of Petitioners on said date."

4. Both contracts so attached (R. 20 to 32 and R. 32 to 44) are between "the United States of America, hereinafter called the Government, represented by the contracting officer, — and E. Jack Smith, individually, trading as E. Jack Smith, of the City of Atlanta in the State of Georgia, hereinafter called the contractor." In each case, the contract is signed by the contractor as follows: "E. Jack Smith, Contractor, 756 Hurt Building, Atlanta, Georgia."

5. The contracts appearing in the record are substantially similar, containing a description of the work to be

performed (omitting specifications and drawings, but containing a reference thereto) providing for changes, change of conditions, examination and inspection; and containing proper safeguards to the Government regarding workmanship and materials, superintendence by the contractor and delay in performance. Special articles in each contract relate to overtime compensation for laborers and mechanics, disputes and rates of wages to be paid by "the contractor or his sub-contractor," and prohibit any rebate of the weekly wages of any person employed on the work to either the contractor or sub-contractor. Article 18 of each contract requires "the contractor, sub-contractors, materialmen and suppliers" to give preference to articles manufactured and produced in the United States.

6. Article 16 of each contract (R. 28 and R. 40) contains the only reference in either contract to the time and manner of payment by the Government to the contractor of the contract price. Sub-paragraphs (c) of this Article 16 of each contract likewise contains the only reference in the record to the ownership of the property with respect to which the contractors perform their services.

This language of Sub-paragraph (c) is as follows:

> "All material and work covered by partial payments made shall thereupon become the sole property of the Government, but this provision shall not be construed as relieving the contractor from the sole responsibility for the care and protection of the materials and work upon which payments have been made, the restoration of any damaged work or as a

waiver of the right of the Government to require the fulfillment of all of the terms of the contract.

7. The record does not disclose when or how title to the account receivable was transferred by E. Jack Smith, individually, designated in the contract as "contractor," to the contractor-partnership which filed the Equitable Bill.

8. The record does not disclose whether the transfer of the contract or of the contractor's right to receive the contract price was made prior to, during or after the performance by the contractor.

9. The record fails to identify the owner of the land or of the site upon which the contractor's services were performed.

PART II.

ARGUMENT AND CITATION OF AUTHORITIES

I. Analysis of Nature of the Taxes Sought to be Collected and of the Property Sought to be Taxed.

The taxes sought to be collected are the uniform ad valorem taxes to which all property in the County (other than classified property) is subject, including real estate, inventories, personal property, accounts receivable and all unclassified property.

A constitutional amendment ratified June 8, 1937, and appearing in Georgia Laws 1937, page 39, authorized the General Assembly to classify property, including money, for taxation, and to adopt different rates and different methods and different classes of such property. This amendment is now codified as a part of Section 2-5001

in the pocket part of the Annotated Code of Georgia of 1933.

Pursuant to this new constitutional authority, the Legislature of Georgia did, on December 27, 1937, enact a law (Georgia Laws 1937-8, Extra Session, page 156) classifying for taxation certain other species of property. Accounts receivable were not classified by this Act to be taxed at the reduced rates. The language of the Act (Section 2, Georgia Laws 1937-8, Extra Session, page 158) is as follows:

> "Accounts receivable and all notes except those representing credits secured by real estate are hereby classified to be taxed as heretofore provided by law and shall not be subject to the provisions of the following sections of this Act."

Accordingly, accounts receivable having been left in the mass of unclassified property, the rule with respect to their taxation is expressed by the Supreme Court of Georgia in the case of

Verdery v. The Village of Summerville, 82 Ga. 138, *Opinion 140*, 8 S. E. 213, *Opinion 214*, in the following language:

> "Once for all, the constitution has enumerated the two classes of property, which enumeration the legislature, the courts and the citizen must recognize as exhaustive; property, whatever its species, is simply exempt or subject to be taxed. If exempt, it pays nothing; if subject, the amount it shall pay is measured by multiplying the fixed rate into the actual value. The result will be, in every instance, that all persons who own taxable property of equal value will pay the same amount of taxes, and all who own

An Act to Authorize the Refunding of the National Debt.

This act authorizes the Secretary of the Treasury "to issue, in a sum or sums not exceeding in the aggregate two hundred million dollars in coupon or registered bonds of the United States in such form as he may prescribe—bearing interest payable semi-annually at the rate of five per cent per annum; also a sum or sums not exceeding three hundred million dollars of bonds—bearing interest at the rate of four and one-half per cent per annum; also a sum or sums not exceeding in the aggregate one thousand million dollars of bonds—bearing interest at the rate of four per cent per annum: *all of which said several classes of bonds and the interest thereon shall be exempt from the payment of all taxes or duties of the United States, as well as from taxation in any form by or under State, municipal or local authority.*" (Italics ours.)

Such is the legislative history of all acts of Congress from which this section of the Code is derived. In each instance, the sole object of Congress was to provide exemption from taxation of interest-bearing securities or Treasury notes of the United States Government. Accordingly, as we pass to the judicial construction of this Code section, we are not surprised to find that the Courts have applied substantially the rule of ejusdem generis in defining the scope of the words "other obligations" as used in this section of the United States Code and Revenue Acts of Congress to which we shall refer.

II.

Prior Judicial Interpretation of this Section of the United States Code Forbids its Application to Georgia's Attempt to Levy a Uniform Property Tax against Georgia's Own Citizen.

The most authoritative decision on this phase of the subject was cited by counsel for Respondents-in-Certiorari on oral argument. This is the California case of

> *Hibernia Savings & Loan Society* vs. *San Francisco* (decided January 29, 1906) 200 U. S. 310, 50 L. Ed. 495, 26 S. Ct. 245.

Among the reasons why this California case is so important are that the tax involved in this California case was a property tax, the property sought to be taxed consisted of "solvent credits" and the taxpayer's defense was based exclusively on Section 3701 of the Revised Statutes, which is now codified as Title 31 of Section 742 of the United States Code.

Other points of parallel between the California case and the Georgia case now before the Court include the following:

> 1. The property assessed as "solvent credits" in the California case consisted of Treasury checks of the United States issued for interest accrued upon registered bonds of the United States. These checks were "payable at the United States Treasury at San Francisco at any time within four (4) months from their date." (Statement of Facts, 200 U. S., pp. 310 and 311.)

By comparison, the property assessed in this Georgia case now before the Court, consists of the contract price for labor, services and materials furnished by an independent contractor to the United States Government payable (as the contract provides) "as the work progresses or at the end of each calendar month, or as soon thereafter as practicable, on estimates made and approved by the contracting officer." (R-28, 40).

2. The reason for assessment in the California case was that the Hibernia Savings and Loan Society had not presented its checks immediately for payment but had withheld them until the first Monday in March, 1899, which was the effective tax date in California.

By comparison, the reason for assessment of E. Jack Smith, Contractor, in the case at bar was the contractor's ownership on January 1, 1942 (which was the effective tax date in Georgia) of an asset which, according to the Constitution and laws of Georgia, constitutes taxable property.

3. The sole basis of the taxpayer's challenge considered by the Supreme Court of the United States was Section 3701 of the Revised Statutes (Title 31, Section 742 of the United States Code). By order of the Court, this brief is limited to a consideration of the effect of this same statute upon the account receivable assessed by Georgia tax officials.

4. The reason for the failure of the Georgia contractor to obtain his money before the effective tax date in Georgia does not appear of record. The Bill

in Equity admits ownership of the account receivable as taxable property, and this admission necessarily, as a matter of good pleading, admits that the contractor had become entitled to receive his money prior to the effective tax date and that on the effective tax date the contractor owned the credit which was assessed.

With this background of comparable facts, we respectfully call attention to the following rulings of the Supreme Court of the United States in the California case:

(a) The court held (Opinion 200 U. S. p. 316) that while the checks were "obligations of the United States" and within the letter of Section 3701 of the Revised Statutes, "they are not within its spirit, and are proper subjects of taxation."

(b) The checks in question were not intended to circulate as money and accordingly did not fall within the letter of the Act of Congress approved Aug. 13, 1894 (28 Stat. p. 278) which is codified as Sections 125 and 126 of Title 31 of the United States Code. Nevertheless, the aim and purpose of the Act of 1894 giving consent to tax circulating notes of national banking associations and other notes and certificates of the United States, payable on demand and circulating or intended to circulate as currency, was compared by the Court with the aim and purpose of Section 3701 of the Revised Statutes and the two Acts were construed together to permit

a State tax levied on "solvent credits" which admittedly were not within the letter of Sections 425 and 426 of Title 31 of the United States Code.

(c) The Court distinguished the following United States Supreme Court decision relating to interest-bearing securities:

Banks vs. *Mayor* 74 U. S. (7 Wall) 16, 19 L. ed. 57.

Weston vs. *City of Charleston* 27 U. S. (2 Peters) 449, 7 L. ed. 481.

Bank of Commerce vs. *New York City* 67 U. S. (2 Black) 620, 17 L. ed. 451.

Bank Tax Case (*People* vs. *Bank of Commonwealth*) 69 U. S. (2 Wall) 200, 17 L. ed. 793.

In connection with the Bank Tax Case, attention is called to the fact that subsequent to the decision in *Bank of Commerce* vs. *New York City*, 67 U. S. (2 Black) 620, supra, the New York Legislature attempted on April 29, 1863 to amend the State law so as to tax indirectly the same stocks of the United States which New York had been forbidden to tax by the direct tax previously laid.

The effect of the second decision (which was the Bank Tax case) was to hold that the new State tax on the capital of a State bank is a tax on the property of the institution, and that when that capital consists of the stocks of the United

States, such a tax is invalid. Clearly this is distinguishable from the case at bar.

(d) In the California case the Court also distinguished *Van Brocklin* vs. *Tennessee*, 117 U. S. 151, 29 L. Ed. 845, 6 S. Ct. 670, which related to an attempt to levy a State tax on government-owned property. Again, the distinction is obvious here.

(e) *Bank* vs. *Supervisors*, 74 U. S. (7 Wall.) 26, 19 L. Ed. 60 related to an attempt to levy a State tax upon notes *issued by the Government*. Congress had power "to coin money and fix the value thereof," (Constitution, Article I, Section VIII, Clause 5). When Congress in this particular case provided for the execution of its own power by the Secretary of the Treasury, it invested these Government-issued notes with tax immunity.

We here emphasize the fact that Congress invested with tax immunity *notes issued by the Government itself*. In our opinion, there is all the difference in the world between express language granting tax exemption in an act of Congress relating to the Government's own exercise of delegated power and an effort to construe general language used in statutes relating to "ways and means for the support of the Government" and the "funding of the floating debt of the United States," so as to find in this general language authority to exempt an independent contractor whose interest in his own contract

and the property and income derived therefrom originated as, and continued to be, the contractor's separate private property."

The point we make here, in the discussion of *Hibernia Savings & Loan Society* vs. *San Francisco* is, that the Supreme Court so construed Revised Statutes, Section 3701 as to confine its operation to the spirit and purpose of the acts of Congress relating to issuance of Treasury Notes and refunding the Government debt. The section of the Code was codified from statutes so construed by the Supreme Court.

"Obligations of a Political Subdivision" Held not to Include Interest on Condemnation Award.

A well-considered District Court decision which discusses and applies *Hibernia Savings & Loan Society* vs. *San Francisco*, 200 U. S. 310, supra, is the New York District Court case of

United States Trust Company of New York vs. *Anderson, Collector of Revenue*, 60 F. 2d. 291.

The Federal Income Tax Statutes of 1926 and of 1928 designated as tax-free interest upon "the obligations of a State, territory, or any political subdivision thereof."

In holding that the liability of a city to make just compensation for condemned property was not an "obligation" of a political subdivision of the State so as to exempt interest thereon from Federal income taxation, the District Court made the following comprehensive and able analysis of the effect to be given to the word "obligation:"

"The word 'obligation' does not necessarily include every duty imposed by law, as plaintiff seems to contend. It is generic, having many meanings. When used in a statute its meaning depends upon the context and the purpose of the enactment. See *Hibernia Savings & Loan Society* vs. *City and County of San Francisco*, 200 U. S. 310, 26 S. Ct. 265, 50 L. Ed. 495.—

"There is no reason to suppose that this statutory exemption was intended to be otherwise than declaratory of the constitutional limitation upon the power of Congress to impose a tax upon an obligation of a state. The court has not been referred to any case in which the exemption has been extended to any obligation other than one to repay money borrowed by a state or a subdivision thereof. *The reason for the statutory exemption does not apply except in cases which involve the power of the government to borrow money, as a means of carrying on the governmental functions.* It has never, so far as the court knows, been extended to include interest paid by a state government on a judgment against it.

"In *Hibernia Savings & Loan Society* vs. *San Francisco*, supra, the reasoning in which applies to this case, though the facts are clearly distinguishable, it was held that checks or orders issued by the United States Treasury for interest accrued upon registered bonds of the United States, which represented obligations to pay money previously borrowed, might be taxed by a state in the hands of the owner without violating Section 3701 of the Revised Statutes (31 USCA, sec. 742) which provides that 'all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal authority.' *A ground for the decision was that the statute was one of those di-*

rected against inter-governmental taxation enacted pursuant to the constitutional immunity of state and federal instrumentalities, and that, since in this case the borrowing power of the treasury was not affected by the tax, the statute did not prohibit the tax in question. (Italics ours).

It was said on oral argument that the only case directly in point on the application of the instrumentalities rule to an account receivable is the New York State Court case of

People, ex rel. Astoria Light, Heat and Power Co. vs. *Cantor* (Court of Appeals of New York, October 2, 1923) 236 N. Y. 417, 141 N. E. 901.

In that case, which was referred to on oral argument as the "gas mask case," the Court of Appeals of New York declined to apply Section 3701 of the United States Revised Statutes because of doubt as to whether an indebtedness owing by the Government to a contractor was comprehended within its terms.

However, the New York Court felt compelled on the authority of *McCulloch* vs. *Maryland* and *Banks* vs. *New York* to hold the account receivable an instrumentality of the Federal Government.

Insofar as the New York Court refused to apply Section 3701 of the United States Revised Statutes to an open account owing by the Government to an independent contractor, the New York Court is supported by the Hibernia Savings & Loan Society case and the United States Trust Company of New York case (60 F. 2d 291, supra) which we have previously analyzed in this brief.

The New York Court's refusal to so extend the term "other obligations of the United States" is further supported by the fact that the Supreme Court has never up to this date extended the application of this section of the United States Code to any obligation outside the class of the particular obligations authorized by the Acts of Congress from which it was codified.

Nevertheless, the New York Court did hold that the account receivable there owing by the Government was exempt from tax, placing its decision upon its own interpretation of *McCulloch* vs. *Maryland* and the New York Court's conception of the implied limitation upon the State's power to tax the Federal Government or its instrumentalities. We are thus brought to the constitutional point which we are requested to discuss in this brief.

III.

Any Attempt by Congress to Prohibit the State from Levying this Uniform Property Tax upon the State's Own Citizen would be an Unwarranted Extension of the Instrumentalities Rule as Defined in McCulloch vs. Maryland, 17 U. S. (4 Wheat.) p. 316, and Accordingly Unconstitutional.

Under our system of government, Congress has only such powers as are delegated to it by the Constitution. It has no inherent powers. Within the framework of the Constitution, powers may be expressed or implied from necessity to support powers expressly conferred.

The history of the convention shows that the framers of the Constitution employed the most skillful diplomacy to bring about agreement between the Federalists who wanted a strong National Government and the "States' Rights" adherents who desired to retain a strong local government. The result, as expressed by the Supreme Court, is that:

> "The Constitution contains no express limit on the power of either a state or the national government to tax the other or its instrumentalities."

Helvering vs. *Gerhardt*, 304 U. S. 405, Opinion 411, 82 L. Ed. 1427, Opinion 1432, 58 S. Ct. 969, Opinion 971, Col. 1.

Discussing *McCulloch* vs. *Maryland*, the Supreme Court of the United States said in

> *Helvering* vs. *Gerhardt* (304 U. S. 411, supra) that it was there held "that a state tax laid specifically upon the privilege of issuing bank notes, and in fact applicable alone to the notes of National Banks, was invalid since it impeded the National Government in the exercise of its power to establish and maintain a bank—"
>
> "It was held that Congress having power to establish a bank—also had power to protect the bank by striking down State action impeding its operations; and it was thought that the State tax in question was so inconsistent with Congress' constitutional action in establishing the bank as to compel the conclusion that Congress intended to forbid application of the tax to the Federal Bank notes." (Opinion 17 U. S. (9 Wheat.) 114.)

In applying *McCulloch* vs. *Maryland* to the facts of the case at bar, we are first met with the all-important fact that in the McCulloch case Congress *in the exercise by Congress of* a delegated power had chartered the United States Bank. The tax was discriminatory in that, by the terms of the Maryland Statute, it was not applicable to a bank chartered by the Legislature of Maryland.

With this factual background, the Supreme Court of the United States laid down important principles which have become and are the origin, scope and limitation of the instrumentalities rule. Beginning on page 429 (17 U. S. (4 Wheat.) p. 429), the Court says with respect to the State's sovereign power:

> "All subjects over which the sovereign power of a state extends are objects of taxation; but those over which it does not extend are, upon the soundest principles, exempt from taxation. This proposition may almost be pronounced self-evident.
>
> "The sovereignty of a state extends to everything which exists by its own authority, or is introduced by its permission; but does it extend to those means which are employed by Congress to carry into execution powers conferred on that body by the people of the United States? We think it demonstrable that it does not—.
>
> "If we measure the power of taxation residing in a state, by the extent of sovereignty which the people of a single state possess and can confer on its government, we have an intelligent standard, applicable to every case to which the power may be applied. We have a principle which leaves the power of taxing the people and property of a state unimpaired; which leaves to a state the command of all its resources; and

which places beyond its reach all those powers which are conferred by the people of the United States on the government of the Union, and all those means which are given for the purpose of carrying those powers into execution."

Again, beginning on page 436 (17 U. S. (4 Wheat.) page 136), the Court says:

> "The states have no power, by taxation or otherwise, to retard, impede, burden or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general Government. This is, we think, the unavoidable consequence of that supremacy which the Constitution has declared—.
>
> "This opinion does not deprive the states of any resources which they originally possessed. It does not extend to a tax paid by the real property of the bank, in common with the other real property within the state, nor to a tax imposed on the interest which the citizens of Maryland may hold in this institution, in common with other property of the same description throughout the state."

Laying to one side any issue of discrimination, which admittedly is not found in the tax sought to be collected, we particularly call attention to the mutuality of the obligation of each of the two sovereignties not to encroach upon the domain of the other. We think the portions of the McCulloch decision which prohibit the taxation by Maryland of a branch of the Bank of the United States are no stronger than the portions, including the closing paragraph of the opinion above quoted, which recognize the right of Maryland to tax the interest of her own citi-

zens even in the same property. (See Opinion, 4 Wheaton, page 436.)

It is our opinion that Congress has so construed and applied the McCulloch decision, and that from its application the following rules have been clearly established:

First. Any tax upon the power of the Government to borrow money, or which restricts the market for Government securities, is held to be a tax upon the Government itself, and for that reason forbidden by *McCulloch* vs. *Maryland*.

Cases supporting this statement have been cited on page 29 of the Main Brief of Respondents-in-Certiorari.

Second. Any tax upon property which is Government owned is forbidden by *McCulloch* vs. *Maryland*.

These cases include *United States* vs. *Allegheny County* cited on page 28 to the Main Brief of Respondents-in-Certiorari and *Van Brocklin* vs. *Tennessee*, 117 U. S. 151 cited in this brief.

Third. "When the National Government lawfully acts through a corporation which it owns and controls, those activities are governmental functions entitled to whatever tax immunity attached to those functions when carried on by the Government itself through its departments."

Graves vs. *New York*, 306 U. S. 466, Opinion 477, 83 L. Ed. 927, Opinion 931, 59 S. Ct. 595, Opinion 597 Col. 1.

Fourth. But if the government or an officer or agent thereof, with the end in view of accomplishing the object of a power delegated to the National Government, chooses at some stage of the proceeding to let by contract to an independent contractor some portion of the work incident to the exercise of a power delegated to the Government, *McCulloch* vs. *Maryland* recognizes the right of the State to impose a tax upon the interest of its own citizen in the contract itself.

This last statement is exactly what the Supreme Court of the United States said in the closing paragraph of the Opinion in *McCulloch* vs. *Maryland* with respect to the interest which citizens of Maryland might have in the branch Bank of the United States.

The two sovereignties existing in our Federal system, as defined in *McCulloch* vs. *Maryland*, are coordinate, and the deference due by the States to the National Government in the field of delegated power is complimentary to the deference due by the National Government to the States in the field of the reserved power.

In discussing the interstate commerce clause of the Federal Constitution and its effect upon State taxation, the United States Supreme Court has several times made the statement:

> "The power to tax property, the sum of all the rights and powers incident to ownership, necessarily includes the power to tax its constituent elements."

Nashville, Chattanooga and St. Louis Railway Co. vs. *Wallace*, 288 U. S. 249, Opinion 267 & 268, 77 L. Ed. 730, Opinion 738, 53 S. Ct. 345, Opinion 350, Col. 1.

McGoldrick vs. *Berwin-White Coal Mining Co.*, 309 U. S. 33, Opinion 52, 84 L. Ed. 565, Opinion 574, 60 S. Ct. 388, Opinion 396, Col. 1.

Accordingly, in appraising the application of Section 742 of Title 31 of the United States Code and also in determining the power of Congress to restrict by acts of Congress the power of the States to tax the States' own citizens who are admittedly within the scope of the sovereign power of the States, taxes upon property and taxes upon the constituent elements of property and the rights and powers incident to ownership thereof must stand or fall together.

We are here suggesting to the Supreme Court that the reach of a decision in this case, upholding the power of Congress by Section 3701 of the Revised Statutes to enter the field of the State's right to tax the State's own citizen will not only strike down an ad valorem tax case, but for the same reasons will strike down a State sales tax or State use tax or a State income tax wherever the origin or the destination of the income received or the property sold can be traced through the contract to the United States Government.

Such an extension of the instrumentalities rule would be out of harmony with all decisions of the United States Supreme Court in cases relating to tax-

ation of independent contractors and, in our opinion, would be an invasion of State power forbidden by *McCulloch* vs. *Maryland*.

It is not necessary to cite again in this immediate connection the very large number of independent contractor cases which have been reviewed in the original brief of Respondents-in-Certiorari.

However, the case of *Metcalf and Eddy* vs. *Mitchell*, 269 U. S. 514, 46 S. Ct. 172, 70 L. Ed. 384, which related to a Federal income tax imposed upon a contractor's earnings for services rendered by the contractor to a political subdivision of a State recognizes the coordinate character and equal importance in our Federal system of the mutual deference due by each sovereignty to the other in the other's particular field. (See Opinion 269 U. S. 521, 522).

After referring to the ruling in *Fidelity and Deposit Company* vs. *Pennsylvania*, 240 U. S. 319, 60 L. Ed. 664, 36 S. Ct. 298, that "mere contracts between private corporations and the United States do not necessarily render the former essential Government agencies and confer freedom from State control," the Supreme Court in this unanimous decision said:

> "These statements we deem to be equally applicable to private citizens engaged in the general practice of a profession or the conduct of a business in the course of which they enter into contracts with the government from which they derive a profit." (Opinion 269 U. S. 525.)

Laying to one side, and not expressing any opinion upon taxes levied in such manner as to directly affect

the Government, and recognizing the fact that there might be interference with such a contract relationship by means other than taxation, the Supreme Court said (269 U. S., Opinion 526.):

> "We to decide that one who is not an officer or employee of a state, does not establish exemption from Federal income tax merely by showing that his income was received as compensation for service rendered under a contract with the state; and when we take the next step necessary to a complete disposition of the question, and inquire into the effect of the particular tax, on the functioning of the Government, we do not find that it impairs in any substantial manner the ability of plaintiffs-in-error (the contractors) to discharge their obligations to the state or the ability of a state or its subdivisions to procure the services of private individuals to aid them in their undertakings."

In another unanimous decision involving a contract between an independent contractor ad the government for carriage of the United States mails, the Supreme Court sustained a gross receipts tax by the State of California upon the gross receipts of the contractor, upon the whole of which he was taxed. Two-thirds of these gross receipts were derived from carriage of the United States mails.

Alward vs. *Johnson*, 282 U. S. 509, Opinion 514, 74 L. Ed. 496, 51 S. Ct. 273, 75 A. L. R. 9.

IV.

A Recapitulation of New Authorities which were Cited by Counsel for Respondents-in-Certiorari only on Oral Argument.

On oral argument, when counsel for taxpayer first suggested that taxation of accounts receivable in this case was forbidden by Title 31, Section 742 of the United States Code, we replied with oral citation to the Supreme Court of *Hibernia Savings & Loan Society* vs. *San Francisco*; 200 U. S. 310, which has been analyzed in Section II of this special brief.

Also, on oral argument, we suggested to the Court that a comparison of *Alabama* vs. *King and Boozer*, 314 U. S. 1, with *Federal Land Bank of St. Paul* vs. *Bismarck Lumber Company*, 314 U. S. 95, which was decided on the same day, would show that the Supreme Court had in those cases applied the "legal incidence" test as the test of constitutionality.

In the King and Boozer case, the legal incidence of the tax was upon an independent contractor.

In the Bismarck Lumber Company case, the United States Supreme Court was dealing with a tax which the Supreme Court of North Dakota had already held was a "sales tax—laid upon the purchaser."

The United States Supreme Court accepted as controlling a North Dakota Supreme Court decision that the incidence of this North Dakota tax was "upon the purchaser." (Opinion, 314 U. S. 99.)

As the Federal Land Bank of St. Paul, the purchaser, was a corporation created by Congress to perform as an agent of the Government, or as the Government itself, a function within the scope of delegated Federal power, Congress was authorized to invest and did invest its agent with immunity from the sales tax sought to be laid upon the Federal Land Bank as purchaser in the Bismarck Lumber Company case.

Had the legal incidence of this tax been on Bismarck Lumber Company rather than the Federal Land Bank, the numerous independent contractor cases cited in our main brief disclose beyond question that the tax would have been upheld, notwithstanding the ultimate posssible increase in cost to the Government.

In closing, we respectfully suggest as an illustration another kind of contract which the Government frequently makes with citizens of the State, that is, a lease contract whereby private property is leased by a citizen of a State to the United States Government, either for a short period of time or for a term of years. Of course, the leasehold interest as Government property is exempt from tax, but the land, as the property of the citizen, pays just as much State and County tax as it did before the lease.

In a case relating to a lease, a contract exists between the United States Government and the citizen by the terms of which reciprocal rights and liabilities accrue. Although such a contract may be for a different purpose than a construction contract, it cannot, in our opinion, be distinguished from a construction contract insofar as the instrumentalities rule is concerned.

We can hardly imagine the Court holding in a given case that the connection of the Government as lessee can be *traced through the contract* and impressed upon the land of the citizen as lessor, in order to relieve the citizen from paying his fair share of ad valorem taxes upon the citizen's property. Neither can we imagine the Court holding that Congress would have authority to make so vast an extension of Federal power.

However, in our opinion, there is no constitutional distinction between an attempt by Congress to trace control through a lease contract and an attempt by Congress to trace control through a construction contract. In either case, *McCulloch* vs. *Maryland*, as we believe, requires that the State be left free to deal with its own citizen not only as to the citizen's interest in the contract itself but as to all property and all rights and powers incident to the ownership thereof and growing out of same.

V.

Restatement of Second Heading on Page 29 of Original Brief.

This study discloses that the *Second* heading on page 29 of the original brief should be amended to fit the facts of the four (4) cases there cited, in each of which the Government, or an officer of the Government, was actively executing a power conferred upon the National Government, either directly or through a corporation which the Government organized, owned and controlled for that purpose.

There is no inconsistency in this brief and any case cited on page 29 of the original brief filed by Respondents-in-Certiorari. However, the statement in the original brief as to what is held by these cases is too broad and disregards the material fact that in each case the Government was acting in exercise of its own power as distinguished from the independent contractor cases in which a different rule has been applied in every case by the United States Supreme Court.

Respectfully submitted,

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